EDISON

Aberdeen UK Tracker Trust

Low-cost UK exposure with a slight discount

Investment trusts

Aberdeen UK Tracker Trust (AUKT) is the only UK investment trust that tracks the FTSE All-Share Index. It seeks to match the index performance closely in both capital and income terms, by investing in all the largest 350 stocks and a majority of those in the FTSE Small Cap Index. The manager points out that more efficient exposure to the broad UK market can be achieved with an All-Share tracker than a FTSE 100 or FTSE 250 tracker, as it does not incur trading costs when stocks move between the large and mid-cap indices. Total expenses of 0.3% are competitive with many open-ended peers, and the discount to NAV, which has been stable in the 4-6% range, offers a slight yield uplift. The trust does not use gearing.

12 months ending	Share price (%)	NAV (%)	FTSE All-Share Index (%)	FTSE 350 Index (incl ITs) (%)	FTSE World Index (%)
31/07/11	12.7	14.7	14.9	14.8	13.5
31/07/12	0.3	(0.1)	0.4	0.5	2.0
31/07/13	26.6	23.6	24.3	24.0	26.3
31/07/14	4.6	5.3	5.6	5.5	4.6

Source: Thomson Datastream. Note: Total return basis, assuming dividends reinvested.

Investment strategy: Doing what it says on the tin

AUKT employs full physical replication for the largest 350 stocks in the FTSE All-Share (those that comprise the FTSE 100 and FTSE 250 indices), which together made up 96.85% of the index market capitalisation at the end of July. Most of the FTSE Small Cap stocks are also held, although a slight underweight to financials versus the index is the result of not holding many of the small, illiquid investment trusts in the lower reaches of the Small Cap Index. AUKT also is unable to invest in itself, being a PLC. Dividends from holdings are kept in cash until the trust's ex-dividend date, which may result in short-term divergence from the total return index but avoids the risk of capital losses from reinvesting dividends in shares that subsequently fall in value, and reduces trading costs.

Market outlook: UK faces balance of influences

While the economic outlook for the UK is favourable, with GDP growth forecast to be the highest in the developed world in 2014 according to the IMF, there are likely to be bumps in the road, with potential UK interest rate hikes, the end of quantitative easing in the US and geopolitical tensions in Ukraine and the Middle East all providing potential downside risk. FTSE All-Share companies derive a large part of their earnings from overseas (see page 4), so external factors should not be underestimated. However, valuation metrics seem reasonable in a historical context.

Valuation: Slight discount, stable in 4-6% range

AUKT's discount to cum-income NAV was 5.4% at 8 September. This is in line with the one-year average, and just below the three- and five-year averages. Assuming the portfolio yield is broadly equal to the index yield, the discount offers a slight yield uplift for investors. AUKT yields 3.3% based on the 8 September share price of 315p. The trust may buy back shares into treasury if the discount is wider than 5%. So far in 2014 330,000 shares have been bought back at a cost of £1.05m.

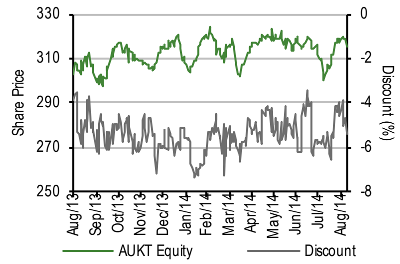
12 September 2014

Price	**315p**
Market cap	**£320m**
AUM	**£335m**
NAV*	330.68p
Discount to NAV	4.7%
NAV**	332.92p
Discount to NAV	5.4%

*Excluding income. **Including income. Data at 8 September 2014.

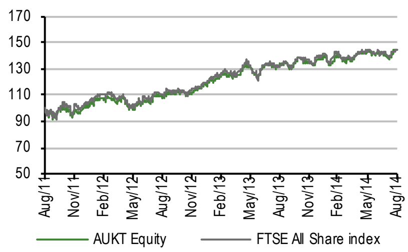
Yield	3.3%
Ordinary shares in issue	101.5m
Code	AUKT
Primary exchange	LSE
AIC sector	UK All Companies

Share price/discount performance*



*Including income. Positive values indicate a premium; negative values indicate a discount.

Three-year cumulative perf. graph



52-week high/low	324p	297.25p
NAV* high/low	334.36p	306.85p

*Excluding income.

Gearing

Gross	0.0%
Net	0.0%

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Edison profile page

Aberdeen UK Tracker Trust is a research client of Edison Investment Research Limited

Exhibit 1: Aberdeen UK Tracker Trust at a glance

Investment objective and fund background

Aberdeen UK Tracker Trust (known as Edinburgh UK Tracker Trust until April 2013) invests in a portfolio designed to track closely the FTSE All-Share Index, in terms of both capital and income. It employs full replication of the FTSE 350 (96.85% of the All-Share at 31 July 2014) and also invests in the majority of FTSE Small-Cap Index stocks.

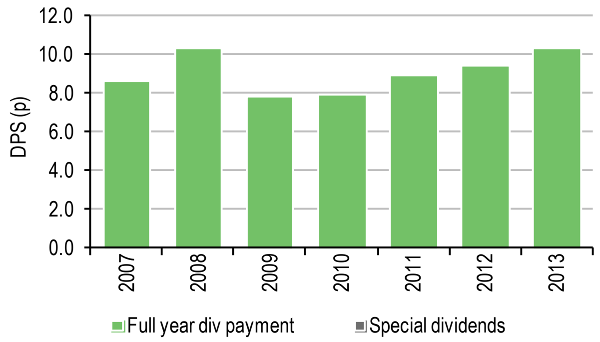
Recent developments

- 29 July 2014: Half-year results for the six months ended 30 June. NAV TR +1.4% versus +1.6% from benchmark FTSE All-Share Index.
- 14 July 2014: Aberdeen Fund Managers Ltd appointed as Alternative Investment Fund Manager (AIFM). Investment management delegated to Aberdeen Asset Managers Ltd, the existing manager.

Forthcoming		Capital structure		Fund details	
AGM	April 2015	Ongoing charges	0.3%	Group	Aberdeen Asset Management
Annual results	March 2015	Net gearing	0.0%	Manager	David Jones
Year end	31 December	Annual mgmt fee	Tiered, 0.09-0.25% (see p 10)	Address	Bow Bells House, 1 Bread Street, London EC4M 9HH
Dividend paid	April, August	Performance fee	No		
Year of launch	1990	Trust life	Indefinite	Phone	0500 00 00 40
Continuation vote	Annual, next in April 2015	Loan facilities	None	Website	www.aberdeenuktracker.co.uk

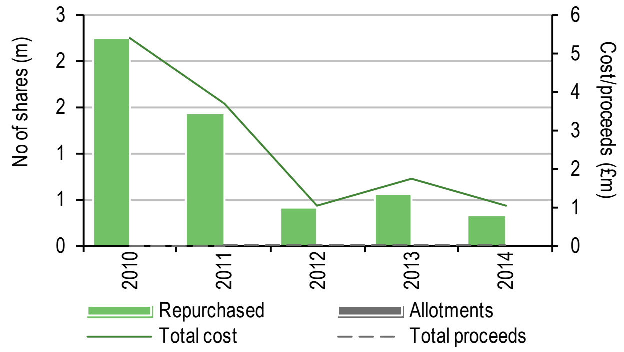
Dividend payments

Dividends paid twice yearly in April and August. The trust will pay out all income received, less expenses. During 2014 dividends will be rebalanced to reflect the flow of earnings in each half-year (see page 10)

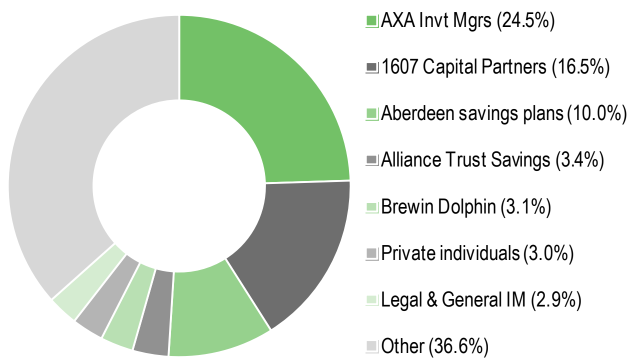


Share buyback policy and history

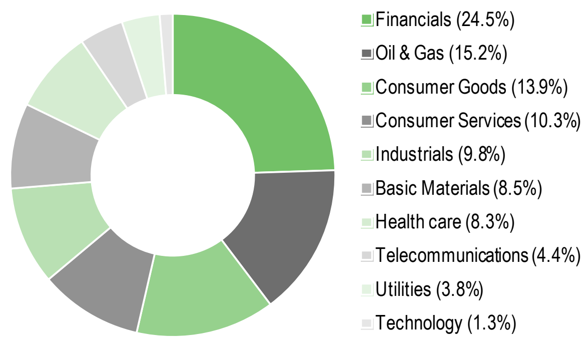
AUKT may buy back shares to manage the discount if it is persistently wider than 5%. Shares bought back are held in treasury.



Shareholder base (as at 28 August 2014)



Industry breakdown of portfolio (as at 31 July 2014)



Top 10 holdings as at 31 July 2014

		Portfolio weight %	
Company	**Sector**	**31 July 2014**	**31 January 2014***
HSBC	Banking	5.9	5.8
Royal Dutch Shell 'A'	Diversified oil	4.7	3.9
BP	Diversified oil	4.3	4.4
GlaxoSmithKline	Healthcare	3.4	3.7
British American Tobacco	Tobacco	3.2	2.7
Royal Dutch Shell 'B'	Diversified oil	3.0	2.8
AstraZeneca	Healthcare	2.7	2.4
Vodafone	Telecoms	2.5	5.4
Diageo	Beverages	2.2	2.2
BHP Billiton	Mining	2.1	N/A
Top 10 (% of portfolio)		**34.0**	**35.4**

Source: Aberdeen UK Tracker Trust, Edison Investment Research, Morningstar, Bloomberg. Note: *Top 10 – N/A where not in top 10 at end January 2014.

Index tracking: The arguments

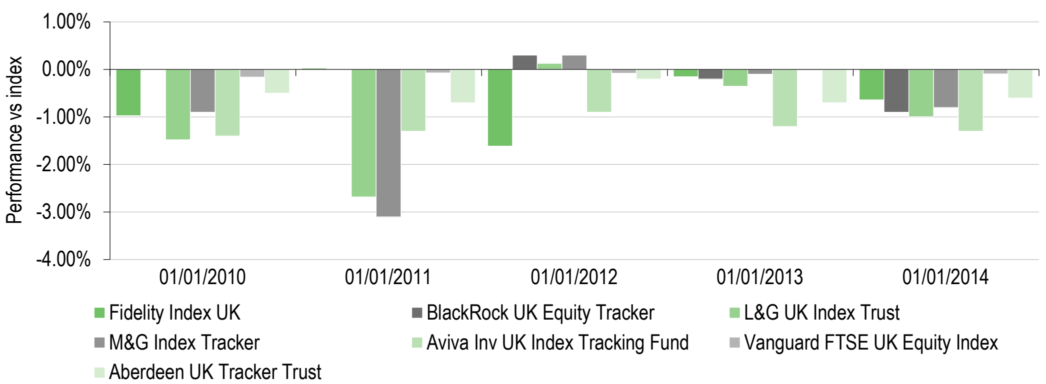
Index tracking has become a huge business in the US, where the world's first tracker fund was launched by Vanguard (a more recent entrant to the UK fund market) in 1976. One argument for this is that the US S&P 500 is notoriously difficult to outperform. The Standard & Poor's Index versus Active scorecard ('SPIVA') to 31 December 2013 showed that while 54% of active funds (US mutual funds investing domestically) outperformed the main US index net of fees over one year, this fell to just 22.5% over three years and 39% over five years. However, the same study showed a similar picture for non-US equity funds, challenging the contention that the S&P 500 is more 'efficient' and thus harder to outperform than other markets. Compared with the S&P 700 Index of international stocks, 55% of active funds (US mutual funds investing internationally) outperformed during 2013, with 40.5% outperforming over three years and 29% over five years.

Another set of figures, produced by index fund provider Vanguard, suggests investors in the UK may have been slightly better served by active fund managers: to the end of 2012, 45% of active UK funds outperformed over five years, with 43% ahead of benchmark over 10 years and 48% outperforming over 15 years. This still points to a slightly worse than even chance of outperforming with an active fund, although it is important to note that as an average figure, it will include a broad range of actual outcomes.

The fact that all these figures include the five bull market years since 2009 is significant; rising markets tend to cast tracker funds in a better light. In a falling market an active manager may outperform or even achieve positive returns; a tracker fund will always follow the market downwards. The Vanguard study shows that while c 60% of active UK fund managers underperformed the index in the current bull market and the previous bull phase from 2003-07, more than half outperformed in the bear markets of 2000-03 and 2007-09.

The question an investor must consider is to what extent they wish simply to be exposed to the stock market. Over the longer term history shows markets tend to rise. A simple average of the returns on the FTSE All-Share over the past 10 calendar years suggests an annual total return of 10.1%. However, the actual outcomes in these years ranged from +30.1% (2009) to -29.9% (2008). Taken over the very long term, the Barclays Capital Equity Gilt Study (which uses data going back to 1899) shows a remarkably stable annual real (ie after inflation) return for UK equities of between 4.5% and 5.5% over 10, 20, 50 and 113 years.

Exhibit 2: Calendar-year performance of tracker funds versus FTSE All-Share Index



Source: Morningstar, Edison Investment Research, fund factsheets. Note: Uses discrete annual performance.

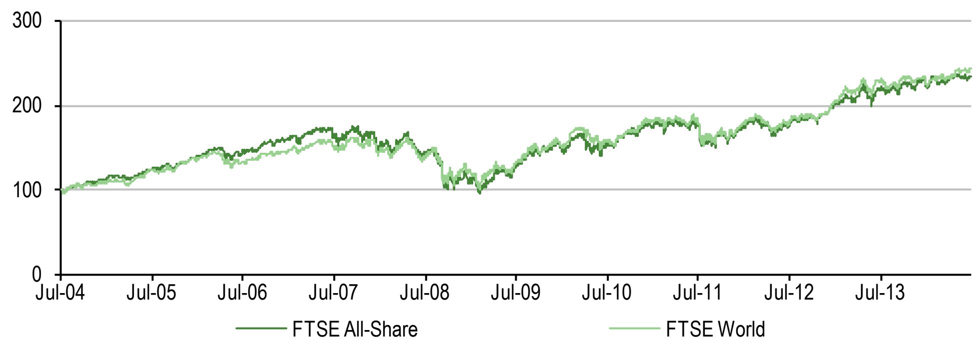
In choosing an index fund, whether as the core of a portfolio or alongside more actively managed funds, the principal considerations (once the investor has chosen which index or indices to track) will be tracking error and cost. The latter will have an impact on the former, as can be seen in Exhibit 11 (peer group comparison), with the highest-charging funds underperforming most noticeably over longer periods. However, the method of index tracking will also have an effect: full replication strategies will tend to match index returns more closely gross of fees but may incur higher transaction costs, while a sampling approach risks missing out on areas of outperformance.

Index-tracking funds are available to UK investors as OEICs, exchange-traded funds (ETFs) or, in the case of AUKT, as an investment trust. Investment trust purchases incur stamp duty at 0.5% and may be subject to dealing fees depending on how they are bought. ETFs are not subject to stamp duty but because they are bought and sold through stockbrokers or online share-dealing platforms, they will incur a dealing fee. A price war among large providers of index-tracking OEICs has seen annual fees on some come down to as little as 0.07%, although the cheapest funds levy a 'service' fee that will increase the total cost of ownership.[1]

The FTSE All-Share as a global proxy

While the FTSE All-Share is an index covering c 98% of UK-listed stocks by market capitalisation, the extent to which performance has mirrored that of the global stock market over the past 10 years is striking (Exhibit 3). This is a result of the large economic exposure of UK-listed companies to overseas markets. Taking as an example the five largest stocks in the index, HSBC, Royal Dutch Shell, BP, GlaxoSmithKline and British American Tobacco are all global businesses. Between them they account for one-fifth of the index. It is estimated that c 75% of FTSE 100 companies' earnings come from overseas, meaning the UK index is far less domestically focused than investors might assume. (Smaller companies tend to be more home-biased, but their impact on the index as a whole is less obvious.)

Exhibit 3: FTSE All-Share Index and FTSE World Index performance



Source: Thomson Datastream, Edison Investment Research. Note: Total return performance.

Three of the top five companies report their results in US dollars, in common with another 19 FTSE 100 members and 35 FTSE 250 companies. A further 11 across the two indices report in euros. This introduces an element of currency risk, as illustrated by the recent strength of sterling; the Q2 2014 edition of the Capita UK Dividend Monitor study estimated that 2014 dividends would have

[1] Research carried out by Edison suggests the choice of trading venue may have as much impact on returns as differences in ongoing charges. Comparing Aberdeen UK Tracker Trust with two of the lowest-cost All Share tracker OEICs and one ETF on three different fund supermarkets/investment platforms and direct from the fund managers produced a wide range of outcomes. This was by no means an exhaustive exercise and there are many different platforms and dealing services offering a wide range of charging structures. While investing £100 a month in AUKT direct with Aberdeen would cost £9.60 over a year, it would cost over £100 to invest the same amount on one platform with a flat annual fee of £75. Costs for investing £100 a month for a year in the two OEICs and the ETF ranged from £5.04 to £99.96. A lump sum of £15,000 (equivalent to one year's ISA allowance) produced a narrower range of results, with the cost of owning AUKT ranging from £120 (again, through Aberdeen's share plan) to £131.95, and the other funds ranging from £63 to £174.50. At larger sums the impact of an annual account fee is lessened, and initial charges had an equivalent impact. So while the annual management fee on a tracker fund will have an impact on returns, and higher-charging funds tend to exhibit significant tracking error over time (see Exhibit 11), it is not the only consideration when choosing such a fund.

been £3.5bn (3.5%) higher if sterling had stayed in line with its average 2013 value against the dollar and euro.

Exhibit 4: Correlations of FTSE All-Share with other indices

	FTSE All-Share	FTSE 100	FTSE World	S&P 500	FTSE World Eur ex UK	MSCI AC Asia ex Jap	Nikkei 225	MSCI EM	UK 10y gilt	UK corp bonds
FTSE All Share	1									
FTSE 100	1.00	1								
FTSE World	0.92	0.92	1							
S&P 500	0.82	0.81	0.95	1						
FTSE World Eur ex UK	0.92	0.91	0.92	0.79	1					
MSCI AC Asia ex Jap	0.80	0.79	0.85	0.72	0.80	1				
Nikkei 225	0.63	0.62	0.77	0.72	0.64	0.66	1			
MSCI EM	0.84	0.83	0.88	0.75	0.83	0.98	0.64	1		
UK 10y gilt	-0.28	-0.27	-0.21	-0.21	-0.23	-0.10	-0.05	-0.10	1	
UK corp bonds	0.42	0.42	0.34	0.23	0.38	0.38	0.25	0.39	0.32	1

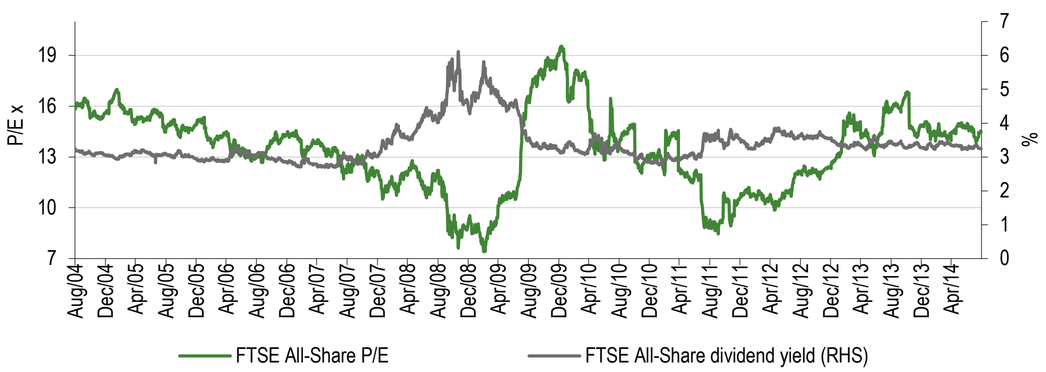
Source: Thomson Datastream, Edison Investment Research. Note: Correlations based on rolling 30-day periods from 29 August 2008.

As shown in Exhibit 4, the FTSE All-Share is almost perfectly correlated with the FTSE 100 (the figure of 0.997 has been rounded up to 1.00), unsurprising given the dominance of the large-cap index in the broader measure. However, correlation of 0.92 with both the FTSE World and FTSE World Europe ex UK indices suggests investors in the UK over the past six years (to end-August) have also largely captured the performance of these markets. The lowest correlation with other equity markets is with Japan, while the only negative correlation shown has been with 10-year gilts.

UK market outlook: In the balance

The uncertainty over the outlook for the UK equity market is evident in relatively muted returns year-to-date: from 1 January to 29 August 2014 the total return on the FTSE All-Share Index was 3.4%. Some factors support a positive outlook – economic growth is forecast to be the highest in the developed world, at 3.2% according to the IMF's World Economic Outlook update of July 2014, while the forthcoming general election in 2015 may see business-friendly policies being advanced. On the other hand, real wage growth remains negative and there is a real possibility of a rise in base rates from their record low of 0.5% within the next six months. The end of quantitative easing by the US may prove a headwind in sentiment terms, although the European Central Bank has hinted at a more accommodative stance. Geopolitical tensions in Ukraine and the Middle East have so far failed to derail global markets, but their potential impact should not be underestimated.

Exhibit 5: FTSE All Share P/E ratio and dividend yield over 10 years



Source: Thomson Datastream, Edison Investment Research

Meanwhile, valuation metrics for the FTSE All-Share suggest UK equities are neither particularly cheap nor particularly expensive compared with historical measures. The trailing P/E ratio was 14.5x at the end of August, 8% above its 10-year average of 13.4x. The dividend yield on the index, at 3.25%, was only slightly lower than the 10-year average of 3.38%. However, as can be seen from Exhibit 5, the 10 years under consideration have seen P/E ratios both significantly above and significantly below their current level. Comparing the UK with other markets using Datastream indices suggests valuations may be a little ahead of peers; the UK Datastream index forward P/E was 19% above its 10-year average at 8 September, compared with 15% for the US and European indices and 11% for the World Datastream Index.

Fund profile: The only IT tracking the FTSE All-Share

Aberdeen UK Tracker Trust was launched in 1990 as the Malvern UK Index Trust, changing its name to Edinburgh UK Tracker Trust in 1997 before taking its current name in April 2013, although it had been part of the Aberdeen Asset Management stable since AAM's acquisition of Edinburgh Fund Managers in 2003. In 2007 the trust merged with Tribune UK Tracker Trust, making it the only investment trust tracking the FTSE All-Share Index. (Since the Edinburgh US Tracker Trust became the North American Income Trust in 2012, AUKT is the only investment trust tracking any index.)

The trust is managed with the objective of closely tracking the capital and income performance of the FTSE All-Share index. It is run by David Jones of Aberdeen's new Quantitative Investments department, formed through the acquisition of Scottish Widows Investment Partnership, which has seen AAM's £7.5bn of tracker fund money swell to £30bn (plus £33bn in other quantitative strategies). Prior to the acquisition around two-thirds of AAM's index-tracking assets were invested the UK, mostly in segregated mandates tracking various FTSE UK indices. This remains broadly similar post-acquisition but also includes some open-ended funds.

The fund manager: David Jones

The manager's view: Closed-end structure keeps lid on costs

AUKT was among the first wave of index fund launches in 1989/90, and is today the only closed-ended tracker fund. Manager David Jones points to the closed-ended structure as a benefit in achieving more index-like returns. Open-ended funds create and cancel units according to investor demand, so there are constant cash flows within the portfolio. Investing inflows or selling holdings to fund outflows incurs transaction costs, which act as a drag on performance and increase tracking error. While AUKT may have to sell some holdings to fund share buybacks, the impact of this has been fairly limited: in the past five years a total of 5m shares have been bought back at a cost of £12.9m, with purchases funded from capital cash, or with cash raised from top-slicing holdings or corporate activity. Jones says the FTSE All-Share benchmark is a further source of cost saving. Holdings do not need to be bought or sold when they move between the FTSE 100 and FTSE 250, or between the FTSE 250 and FTSE Small Cap indices. Turnover of the FTSE All-Share Index is historically low, a key feature of a cost-efficient index.

While the trust's discount has been relatively stable, the disparity between share price and NAV may represent an opportunity for investors when the discount is at the wider end of its range. With NAV returns closely matching those of the index, any narrowing of the discount would see share price returns exceeding those on the All-Share, although of course the reverse is also true.

Asset allocation

Investment process: Matching the vast majority of the index

AUKT employs a process of physical replication, buying shares directly in the constituents of the FTSE All-Share rather than gaining exposure synthetically through the use of derivatives. This avoids exposure to counterparty risk. The top 350 stocks are replicated in full, with the manager owning them in the same proportions as their weight in the benchmark. For the FTSE Small-Cap, the trust holds stocks accounting for the majority of the index's market capitalisation, although c 50 of the smallest constituents are not held.

The merger with Tribune UK Tracker Trust in 2007 brought many small-cap holdings to the portfolio; these have largely been maintained. Jones says he would not buy new small-cap holdings for AUKT unless he could take a position of at least £25,000. Exposures are monitored continually at sector as well as stock level, and if not holding, say, 20 very small stocks with similar businesses meant the portfolio began to diverge from the index in sector terms, Jones would move to rectify this.

Additions or deletions from the portfolio are largely dependent on new issue inclusions at the quarterly index rebalancing, and any corporate actions (such as takeovers) leading to stocks leaving the index. Trading takes place when index changes occur – generally at the quarterly rebalancing for new issues (IPOs are only included intra-quarterly if they represent more than 1% of the full market capitalisation of the FTSE All Share Index – the last new issue to which this applied was Glencore in 2011). Trades are timed to minimise transaction costs, which in practice tends to mean trading as close as possible to the effective date for index changes, when brokers offer lower commissions because they are transacting larger volumes of business.

AUKT's objective is to match the FTSE All-Share Index return as closely as possible in both capital and income terms. Dividend income from portfolio holdings is usually invested in liquidity funds (see Dividend section), as reinvesting it in the underlying shares exposes the income to market risk owing to the difference in timing between receipts and AUKT's own half-yearly dividend payments.

Current portfolio positioning

Positioning of the AUKT portfolio closely reflects that of the FTSE All-Share Index, with the top 350 stocks (which represented 96.85% of the All-Share market capitalisation at 31 July 2014) replicated in full. The top 10 stocks made up 34% of the portfolio, slightly lower than six months previously, and 585 investments were held in total, out of a possible 635. The most significant divergence from the index (0.2 percentage points) was in the financials sector, with a 10-12bps underweight position in equity investment instruments making up the majority of this.

The reasons for this underweight are twofold: first, the FTSE Small Cap Index contains many small and relatively illiquid investment trusts; not holding these stocks cuts down on costs and has effectively no impact on performance. Secondly, the trust cannot hold its own shares within its investment portfolio (although it does hold some in treasury as a result of share buybacks), so AUKT is the largest stock underweight relative to the index. Its c £320m market cap puts it towards the larger end of the FTSE Small Cap Index.

Exhibit 6: Sector allocations (% unless stated)

	Portfolio end July 2014	Portfolio end January 2014	% change Jan-July	FTSE All Share weight at end July
Financials	24.5	23.9	0.6	24.7
Oil & Gas	15.2	14.1	1.1	15.2
Consumer Goods	13.9	12.9	1.0	13.8
Consumer Services	10.3	10.9	-0.6	10.2
Industrials	9.8	11.9	-2.1	9.8
Basic Materials	8.5	6.4	2.1	8.5
Health care	8.3	7.6	0.7	8.4
Telecommunications	4.4	7.3	-2.9	4.4
Utilities	3.8	3.6	0.2	3.8
Technology	1.3	1.4	-0.1	1.3
	100.0	**100.0**	**0.0**	**100.0**

Source: Aberdeen UK Tracker Trust, Edison Investment Research.

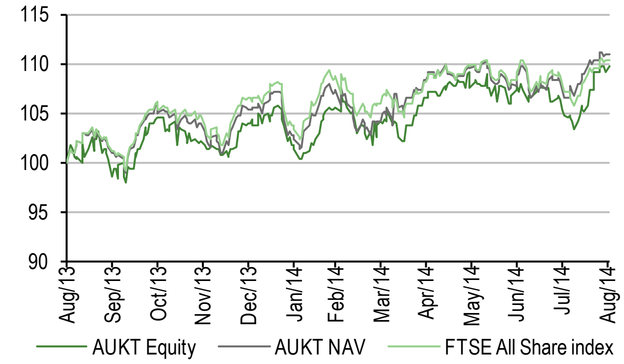
Turnover in the portfolio is low (c 2.8% in FY13); unlike a FTSE 100 or FTSE 250 tracker, the trust does not need to rebalance when companies move between the indices that make up the All-Share.

Low turnover helps the trust to remain low-cost: trading costs in FY13 were £31,000, or c 0.01% of market capitalisation.

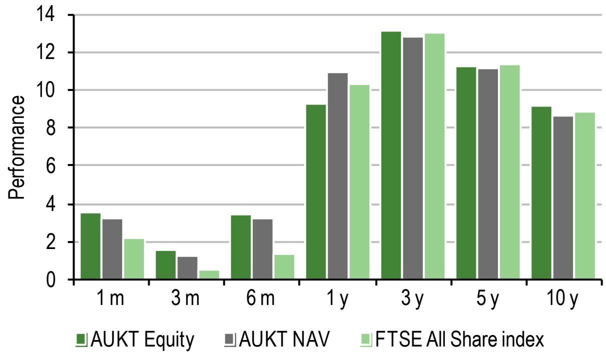
Performance: Doing what it sets out to do

Exhibit 7: Investment trust performance

Price, NAV and benchmark one-year total return performance



Price, NAV and benchmark total returns (%)*



Source: Thomson Datastream, Edison Investment Research. Note: *Three, five and 10-year figures annualised.

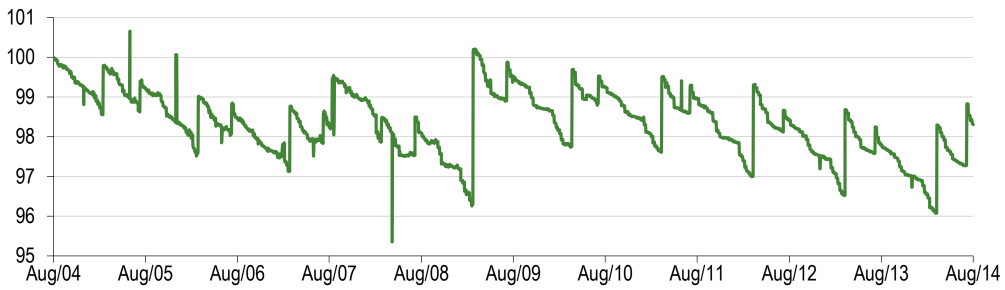
Exhibit 8: Share price and NAV total return performance, relative to indices

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to FTSE All Share index	1.4	1.0	2.0	(0.9)	0.1	(0.5)	2.9
NAV relative to FTSE All Share index	1.1	0.7	1.8	0.5	(0.6)	(1.2)	(1.7)
Price relative to FTSE 350 (inc ITs)	1.4	1.0	1.9	(0.9)	0.3	(0.3)	2.7
NAV relative to FTSE 350 (inc ITs)	1.1	0.7	1.7	0.6	(0.4)	(1.0)	(1.9)
Price relative to FTSE World Index	(0.4)	(2.2)	(3.9)	(3.6)	(3.5)	(3.7)	(2.3)
NAV relative to FTSE World Index	(0.7)	(2.5)	(4.1)	(2.1)	(4.2)	(4.3)	(6.7)

Source: Thomson Datastream, Edison Investment Research. Note: Data to end August 2014. Geometric calculation.

AUKT's NAV performance is, unsurprisingly, closely in line with that of the FTSE All-Share Index (Exhibit 7), with slight underperformance owing to the impact of fees compounding over time (Exhibit 8). This suggests the strategy of full replication of the FTSE 350 index with partial replication of the smallest stocks is sufficient to achieve index-like results overall. Shorter-term divergences (for instance, the 1.8% NAV outperformance over six months seen in Exhibits 7 and 8) are largely a technical factor reflecting the trust's dividend payments, which affect relative total return performance for short periods. This can be observed in Exhibit 9 (the scale has been magnified and substantially all data points are between 96 and 101), where the drops in relative performance coincide with the trust's ex-dividend (xd) dates. The interim xd date in July/August has historically caused a smaller relative drop than the final xd date in April, but with the move to rebalance the dividend (see Dividend section below), the two dips will look more equal in future.

Exhibit 9: NAV performance relative to FTSE All Share Index over 10 years



Source: Thomson Datastream, Edison Investment Research

Share price performance is likely to diverge from the index more than NAV performance; this can be seen in Exhibits 7 and 8, showing share price underperformance of NAV and benchmark over one year, but outperformance over both shorter and longer periods.

Discount: Stable at around 4-6% level

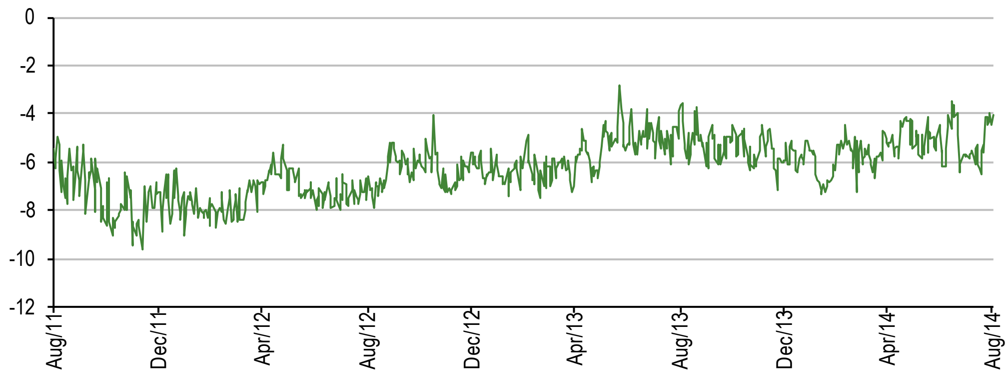
At 8 September, AUKT shares were trading at a 5.4% discount to cum-income NAV, exactly in line with the one-year average. This is narrower than average levels over three and five years (6.2% and 6.6% respectively), but wider than with the 10-year average of 4.2%. Having reached a five-year low of 2.5% in August 2011, the discount widened briefly to a three-year high of 9.6% in December 2011, before settling back into a range broadly between 4% and 6%. While it does not have a formal discount control mechanism, the board of AUKT closely monitors the discount to NAV, and may buy back shares if the discount widens. So far in 2014 (to 9 September), 330,000 shares have been bought back into treasury, at a cost of £1.05m.

One effect of the discount is to provide a slight uplift to the yield on the FTSE All-Share Index (17bps based on a yield of 3.3% and a 5% discount). However, as the discount can fluctuate this should not be viewed as a permanent advantage.

There is scope for the discount to narrow from its current level (on an ex-income basis the shares have traded close to par on several occasions in the past year), although it is unlikely they would ever trade at a sustained premium given AUKT's remit is to track an index; the ready availability of open-ended equivalents that always trade at par would act as a limiting factor.

The presence of two very large shareholders on the register (AXA Investment Managers with 24.5% and 1607 Capital Partners with 16.5%) could be seen as a risk in terms of the discount. However, while 1607 takes a discount-aware approach to investing, it is not an 'activist' as such and is using AUKT as a means of getting low-cost UK equity exposure at less than NAV, rather than trying to arbitrage the discount. Aberdeen says AXA has been a long-standing supporter of AUKT and the nature of the funds holding the trust suggests capital gains liability should help avoid excessive market overhang in the event of any reduction in the holdings.

Exhibit 10: Discount over three years (to cum-income NAV)



Source: Morningstar, Edison Investment Research

Capital structure and fees

AUKT is a conventional investment trust with one class of share (10p ords). At the end of August there were 101.5m shares in issue, with a further 1.5m held in treasury as a result of share buybacks. As its aim is to replicate the performance in capital and income terms of the FTSE All-Share Index, AUKT does not use gearing. While it could be employed to offset the impact of running costs and thus reduce tracking error in rising markets, in a falling market gearing would lead to underperformance.

Aberdeen Fund Managers Ltd receives a management fee of 0.25% of total assets less liabilities, falling to 0.1% on assets in excess of £100m, and to 0.09% above £250m. Assets are currently a little over £300m and for the year ended 31 December, the management fee worked out at 0.14%. Other fees (directors' remuneration, fees for auditors, custody and registrar, marketing and other expenses) were roughly equal to the management fee, and brought the ongoing charges figure for FY13 to 0.30%. This is competitive with many open-ended tracker funds (see Exhibit 11), although a price war among some of the larger players (Vanguard, Fidelity) is putting downward pressure on fees in the open-ended space.

AUKT conducts an annual continuation vote as a means of ensuring it is still relevant to the objectives of its investors, and the independent board of directors is likely to monitor developments in the broader UK index-tracking market closely on behalf of its shareholders.

Dividend policy

AUKT aims to pay out all the income it receives after accounting for operating expenses. Two dividends are paid, an interim in August and a final dividend in April. For the year ended 31 December 2013 the interim dividend was 2.75p and the final dividend was 7.55p, making a total dividend of 10.3p (up 9.6% on a year previously). From the current financial year the board is rebalancing the dividend so it more accurately reflects income received during the two halves of the year. Historically the interim dividend (in respect of the first six months of the year) has been lower than the final dividend, but in practice FTSE All-Share companies pay out more dividends in the first half of the year than the second. The interim dividend for the year to 31 December 2014, announced at the half-year results in July, was 5.7p, more than double last year's interim dividend, but the final dividend will be lower than last year as a result.

As FTSE All-Share Index constituents pay dividends throughout the year whereas AUKT pays them twice-yearly, dividends received are invested in a liquidity fund (which shows up as revenue cash on the balance sheet) until the xd date of the trust. The board chooses to manage dividends in this way rather than reinvesting in the shares themselves, which risks squeezing dividends if share prices fall between the payment of the dividend by the portfolio company and AUKT's xd date. Based on the 8 September share price of 315p, AUKT's yield was 3.3%.

Peer group comparison

Exhibit 11 shows the performance of AUKT in the context of two peer groups: investment trusts from the AIC's UK All Companies sector that invest principally in equities and use the FTSE All-Share as a benchmark or reference index (eight out of 16 trusts in the sector), and open-ended funds that track the FTSE All-Share Index. In a long bull market for equities (albeit one that has stuttered recently) it is unsurprising that AUKT ranks towards the bottom of the peer group in performance terms (one, three and five years, and also for risk-adjusted performance as measured by the Sharpe ratio), as all the other trusts in the group use gearing. However, AUKT has the lowest ongoing charges and also the second highest yield.

Measured against the group of 14 open-ended FTSE All-Share tracker funds, AUKT has performed well in NAV terms, with the highest total return over one year and returns in the top one-third of the group over three and five years. Its ongoing charges were below average, although what is clear from the table is that while costs overall are fairly low, there are still some tracker funds charging the kind of fees more often seen on actively managed funds, and this has had an understandable impact on these funds' performance. AUKT's share price performance is ahead of the average over one, three and five years.

Exhibit 11: UK All Companies investment trusts and FTSE All-Share Index trackers

% unless stated	Market cap (IT)/fund size (OEIC) £m	TR one year	TR three years	TR five years	Ongoing charge	Discount	Net gearing	Yield	Sharpe NAV 1 year	Sharpe NAV 3 years
Investment trusts										
Aberdeen UK Tracker Trust	**323.8**	**10.7**	**51.5**	**71.4**	**0.3**	**-4.2**	**98.0**	**3.2**	**1.0**	**0.6**
Artemis Alpha Trust	131.2	15.8	23.2	75.1	1.0	-12.2	116.0	1.1	1.6	0.2
Fidelity Special Values	482.9	9.6	93.6	80.8	1.2	-5.5	124.0	1.8	1.3	1.1
Henderson Opportunities	74.8	15.7	100.9	155.7	1.0	-0.5	110.0	1.1	2.4	1.0
Invesco Perp Select UK Equity	59.6	15.6	88.5	137.7	1.1	-2.7	117.0	3.5	1.6	1.4
Keystone	235.4	12.8	71.4	109.6	1.0	-3.7	105.0	2.9	1.5	1.4
Schroder UK Growth	276.0	2.8	65.8	93.1	0.9	-5.9	108.0	2.6	0.5	0.7
Threadneedle UK Select Trust	40.3	12.6	46.4	54.9	1.6	-1.9	114.0	2.4	1.3	0.4
Sector weighted average		**16.3**	**70.5**	**89.6**	**0.9**	**-5.2**	**111.5**	**2.4**	**1.2**	**0.9**
AUKT rank in sector	**2**	**6**	**6**	**7**	**8**	**5**	**8**	**2**	**7**	**6**
Open-ended tracker funds (+AUKT)										
Aberdeen UK Tracker (NAV)	**335.2**	**10.7**	**51.5**	**71.4**	**0.30**					
Aberdeen UK Tracker (Share price)	323.8	10.2	53.6	79.1	0.30					
Allianz UK Index	18.4	9.2	49.9	67.2	0.79					
Aviva Inv UK Index Tracking Fund	759.9	8.9	47.4	64.5	0.93					
BlackRock UK Equity Tracker	8000.0	9.8	52.1	71.3	0.21					
F&C FTSE All Share tracker	413.5	9.4	50.7	68.7	0.36					
Fidelity Index UK	1209.0	9.6	50.4	68.2	0.30					
Henderson UK Index	259.0	9.2	49.9	67.3	1.20					
HSBC FTSE All Share Index fund	1044.4	9.7	51.8	69.8	0.17					
Legal and General UK Index Trust	4628.9	9.3	50.1	66.4	0.56					
M&G Index Tracker	509.8	8.4	49.9	69.7	0.46					
Old Mutual UK Index fund	180.9	9.5	49.6	68.9	0.49					
Scot Wid UK All Share Tracker	8893.3	8.5	51.2	69.1	0.36					
Scottish Mutual UK All Share Index	17.0	9.9	52.7	73.0	0.08					
Vanguard FTSE UK Equity Index	1551.4	10.0	52.1	72.6	0.15					
Virgin Money UK Index Tracking	2664.7	8.4	46.7	64.9	1.00					
FTSE All-Share index		**10.1**	**52.4**	**73.4**						
Group weighted average		**9.1**	**50.7**	**69.0**	**0.4**					
AUKT (NAV) rank in group	**11**	**1**	**5**	**4**	**10**					

Source: Morningstar, FE Trustnet, Edison Investment Research. Notes: TR=total return (NAV unless stated). The Sharpe ratio is a measure of risk-adjusted return. The ratios we show are calculated by Morningstar for the past 12- and 36-month periods by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. Net gearing is total assets less cash/cash equivalents as a percentage of shareholders' funds. Discount on an ex-income basis. Priced as at 27 August 2014.

The board

AUKT has five directors. Chairman Kevin Ingram joined the board in March 2010 and became chairman in April 2013. Christopher Purvis, the senior independent director, has been on the board since 2007. David Hager also joined the board in 2007. Wendy Mayall and Paul Yates were appointed in March 2012. All the directors are independent of the manager.

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